

Congress of the United States
House of Representatives
109th Congress
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6515

April 1, 2005

Mr. Gary M. Jackson
Assistant Administrator for
Size Standards
U.S. Small Business Administration
409 Third Street, S.W.
Washington, DC 20416

Re: RIN 3245-AF22 – Small Business Size Standards; Selected Size Standards Issues

Dear Mr. Jackson:

We are writing to you in our capacity as Members of the Committee on Small Business. As you are aware, the Committee has jurisdiction over the programs offered by the U.S. Small Business Administration (SBA).

Specifically, this letter is in response to the SBA's request for comments on its Advance Notice of Proposed Rulemaking (ANPR) regarding restructuring size standards. It is our expectation that as the SBA moves forward with its effort to make broad changes to the existing size standards methodology, it consider these comments to be informed. Committee Members have participated in numerous meetings on this issue with small businesses and their representative associations covering a broad array of industries.

There are several issues of note with the size standards changes as originally proposed by the SBA in March of 2004. The first is the receipts-to-employee conversion factor, and its impact on certain industries. Secondly, for certain types of businesses, two size standards were proposed. Lastly, intended change violates agency regulatory processes and procedures under law.

One of the major problems with the size standards modifications as originally offered is the impact on companies with part-time and seasonal employees, particularly the construction and restaurant industries. Historically, when size standards have been modified, each industry has been evaluated individually and independently. This time, the SBA used an across-the-board conversion factor, applied to all industries, when it adjusted all revenue-based measures to employee-based factors.

Census data from 1997 was used to calculate an employee to revenue ratio. An adjustment was made for inflation, and the resulting factor was then applied to each industry's current revenue size standard. Unfortunately, this did not take into account variances in revenue generated per employee that is common in several industries. Not every industry requires the same number of employees to generate revenue. In fact, in the preamble for the proposed change, reference was made to a contemplated change in the early 1990s that because of "unacceptable anomalies" was not adopted. This is exactly what has occurred in this most recent attempt at a conversion factor.

While the SBA has always counted part-time and seasonal employees as full-time when evaluating whether a business is "small," this has not been a problem for many companies that are dependent upon seasonal and part-time employees, as these industries have historically been measured on a revenue-basis. Only when the suggested conversion to employee-based standards occurred, did these businesses even become aware that part-time employees were considered the same as full-time employees in an employee count for the purposes of size standards.

Another notable issue with the proposed change was that two concurrent size standards were proposed for industries that tend to rely heavily on subcontracting. After the receipts-to-employee calculation occurred, those 36 size standards were also assigned a receipts cap. In order to be a small business for companies performing in these industry categories, the company would be required to have fewer employees than the employee-based size standard, as well as less revenue than the additional receipts-based size standard. Each company would be required to be "small" under both size standards rather than for one or the other.

The concern expressed in the proposal, was that some businesses might intentionally subcontract a larger portion of work to other companies, in order to retain their small business status regarding the number of their employees. The additional receipts size standard was imposed so that a small business would not benefit from excessive subcontracting.

Finally, the suggested changes violated a number of provisions set forth in the Regulatory Flexibility (RegFlex) Act and the Administrative Procedures Act (APA). First and foremost, the number of businesses estimated to gain or lose small business classification, was vastly understated. With any regulatory action, agencies are required to identify the impact on small firms. By not taking into account the ripple effect of size standards throughout every federal agency that relies on size standards, and by not considering small business subcontractors and suppliers, this basic premise of the RegFlex Act was violated. It is unfortunate that the SBA, of all agencies, would not conduct a more comprehensive evaluation of small business impact.

Given that the intent of the proposal was simplification, in certain circumstances, the changes were more complex. Further, rather than historic industry-by-industry evaluations a conversion factor was used that did not take into account industry variances. These two issues constituted not only irrational rulemaking under the APA, but also abuse of agency discretion.

The preceding review of the March 2004 proposed regulation is extremely relevant, in that it serves as the basis for a framework the Committee expects in any new rule promulgated by the SBA. We intend that the SBA follow this guidance designed to ensure the rule has the least impact possible on small businesses.

First and foremost, we are greatly concerned that the SBA is compelled to restructure the size standards methodology. Based on our meetings with a wide spectrum of industry representatives and small business owners, the overwhelming comment was that an overhaul is unnecessary. While the size standards as currently structured are not without certain problem areas, these issues could be resolved without the drastic approach currently being considered by the SBA. Therefore, because this is the threshold question, we expect the SBA to re-visit the issue of whether a complete re-examination of the existing methodology is needed.

Given the SBA's clear intent to restructure size standards, the first question that must be addressed is why. It has come to our attention that a restructuring proposal does not seem to be based on what is best for small businesses, but instead is agency driven. The SBA has consistently referred to the need to make size standards less complex. The question is, for whom? In its March 2004 proposal, SBA stated that it, "...believes that these simplified size standards will be less of a hindrance to small businesses that would like to participate in Federal small business programs and to personnel involved in small business Federal procurement and lending programs." From comments provided by a number of small business owners and industry representatives the Committee consulted with, it was learned that small businesses are less concerned with complexity and more concerned with accuracy. Therefore, we expect the SBA to reevaluate whether its size standard streamlining proposal is designed to simplify procurement for agency personnel or to help and protect small companies. The final regulation must protect small firms.

As the SBA moves from receipts-based to employee-based size measures, any proposal offered by the SBA should not result in disincentives that would preclude small companies from hiring additional employees. Three-quarters of the nation's workforce is employed by a small business. Putting these companies in the position of not hiring additional personnel in order to stay below an arbitrary employee-based size standard is not acceptable.

In any re-vamp of the existing size standards methodology, it is expected that each industry will be evaluated individually. Accounting for industry-specific variances has been the hallmark of SBA size standards since their inception. By not evaluating each industry by itself, the SBA would be ignoring a number of important concerns. As an example, different industries require varying numbers of employees to generate revenue. Additionally, some industries have consolidated more dramatically than others, such that the industry is comprised of very large companies and small companies with virtually no middle ground. For small businesses in general, and size standards specifically, a one-size-fits-all approach is never in the best interests of small companies. The Committee has long recognized that with small businesses a targeted approach that has the flexibility to take into account different industries is the only solution. Unfortunately, the SBA has failed to grasp this. We are opposed to any methodology proposed by the SBA that does not include an industry-by-industry analysis as not reflective of the concerns of the small business community. It is only by reviewing the characteristics of each industry on its own, that the SBA is able to accurately determine whether a business in a certain industry is “small.”

Under no circumstance should the SBA require more than one size standard for any individual industry. Requiring small businesses to certify as “small” for two size standards when only one measure was previously required, would be overly burdensome and would, by definition, be more complex. In its final rule, the SBA should avoid creating unnecessary barriers for small firms.

If the SBA does propose a regulation which successfully incorporates small business concerns, to the extent that any resultant regulation results in the displacement of companies from the “small” classification, the Committee expects that the SBA will allow a fixed period of time for companies to readjust to the new size standards. We are aware that the SBA has already objected to a so-called “grandfathering” provision with respect to size standards. The SBA has publicly commented that a business is either “small” or not. This inflexibility in the face of significant change is disconcerting. As such, we believe the agency may have misjudged the impact of a size standards change on small companies.

One of the most obvious flaws in the current size standards methodology is the arbitrary nature of size measures. Given that a company having one employee over, or one dollar over, the size standard is no longer “small,” the standards as currently structured do not allow sufficient flexibility for business growth. This results in a company being considered “small” one year, “other than small” the next, and back to “small.” A “growth factor,” which would allow businesses to re-certify as “small” if they were within 20 percent of a receipts-based size standard or within 5 percent of an employee-based measure, has been previously suggested. Additionally, we are considering other legislative options to provide this necessary stability to size standards.

To the extent that the SBA intends to reduce certain size standards, we expect the inclusion of a provision to allow small businesses to gradually become accustomed to the increased competition that such a reduction would force. While the Committee is strongly supportive of a “grandfathering” provision, we recognize that it must be time limited.

In addition to our concerns regarding the substantive provisions, the SBA has previously skirted its responsibilities in complying with the RegFlex Act. The SBA's final rule must adequately identify the number of businesses impacted by the size standards methodology. It is expected that the SBA will take into consideration the impact of any size standards changes on the ability of large prime contractors to achieve their small business goals. Further, the SBA should evaluate the impact on suppliers and subcontractors to existing small businesses. Without a comprehensive understanding of the impact of the proposal on small companies, the SBA will be unable to put forth a logical, reasonable change. Given the importance of ascertaining the impact this regulation will have on small companies, the Committee expects that the SBA will conduct a more detailed review of programs and initiatives designed to assist small companies and the impact a size standard change would have on the ability of small firms to access these important tools.

In the ANPR of December 3, 2004, the SBA expressed that it intends on holding a series of public meetings on size standards. Thus far, the agency has not published a list of meetings nor made the public aware of when and where such meetings will occur. It is expected that the purpose of these public meetings will only be to solicit input from small business owners that will be taken into consideration prior to the development of a proposed rule as required by the RegFlex Act.

It is of particular concern that the SBA did not comply with its regulatory responsibilities under the law in the development of the March 2004 proposed rule. The fact that no public meetings have been held on the ANPR does not bode well for full small business inclusion in the regulatory process. The issuance of the ANPR and the subsequent extension of the comment period were encouraging, but we are not convinced that the SBA's motives for making broad changes to existing size standards are in the best interest of small business growth and development.

Given the fact that size standards play such an important role for thousands of businesses – serving as the gateway to every program offered by SBA and a number of other agencies' initiatives, including tax credits and regulatory relief – it is crucial to assess the impacts that even the most minor of changes can have. The SBA's original foray into changing size standards was a poorly planned and developed policy initiative, as evidenced by the huge outcry among small business owners and their representative associations, leaving the agency with no choice but to withdraw its proposal. We are hopeful the SBA learned from this misstep and that, as they proceed, they will make sure to gauge the impact of change on small businesses and obtain the necessary feedback to allow them to properly understand the ramifications of their intended overhaul of size standards. However, the Committee remains skeptical that such a drastic re-vamp needs to be done at all.

These comments are provided as guidance for the agency as it moves forward. To the extent that the SBA proceeds without consideration of these concerns, we will have no choice but to consider legislative options available to the Committee. In order for the SBA to accomplish the proper analysis, they must look at the true impact on small businesses and ensure that any change, even a minor one, will improve the environment for small businesses and not work to the detriment of our nation's small firms.

If you have any questions about this letter, please contact LeAnn Delaney of the Committee staff at (202) 225-4038.

Sincerely,












